

MERS and Retiree Health Care Pooling Options

Retiree Health Care Reforms Committee Michigan House of Representatives

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MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM

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What is MERS?

- MERS: voluntary municipal employee pension plan, created by Legislature in 1945 (PA 135): first statewide municipal pool
- 1976 AG # 5076: State has no funding liability under MI Const art 9 sec 24 for any local government pensions
(State oversight where no state \$\$ in MERS, all local funding)
- On 8/15/1996, MERS separated from State, as a statutory public corporation (1996 PA 220, MCL 38.1536(2))
(Unanimous vote in both Houses)
- MERS is only MI example of a state agency removed from state government that continues operations as a public body
(A statutory public corporation, an instrumentality of all MERS participating municipalities and courts, administered by Retirement Board)



Who are MERS Members?

- 700 municipalities in MERS pool, in over a thousand pension, health or ancillary products (506 municipalities in 1996)
- 75,000 participants including 21,000 retirees
(52,000 participants in 1996)
- MERS is a tax qualified 'governmental plan' trust -- tax exempt under federal and state law
(IRS Letter Favorable Determination Letter dated 6/15/2005: Internal Revenue Code 401(a) trust & tax exempt per 501(c)(a))
- MERS Board invests all \$6 B+ trust assets
(Subject to MI Public Employee Retirement System Investment Act, 1965 PA 314)
- MERS, as first and sole statewide municipal "pool," has 60+ year record of success managing change & complexity



Who Operates MERS?

- MERS Retirement Board is trustee and fiduciary
- Local government composition of 9 Member Board (3 year terms)
 - 3 officer plus 3 employee members elected by participating municipalities
 - 1 retiree plus 2 public members (all appointed by Board)
- The voluntary nature of MERS participation
 - + evolving fiscal and employee benefit needs of municipalities
 - = ongoing force to improve and innovate pooled benefits



MERS and Health Pooling ...

- In 2001, at the request of MERS members for HELP, Board directed feasibility study of pooled health care programs.
- Exhaustive review of federal and state law: pooled health and ancillary benefits within overall MERS structure.
- Perceptual shift from MERS as a pension plan, to MERS as a provider of pooled employee benefit programs for municipalities.



Legal Issues

- 1996 MERS independence act (PA 220) empowered Board "to establish additional programs including but not limited to DB and DC programs"
- State laws on intergovernmental contracting and pooling (1951 PA 35; UCA of 1967; MERS Act, 1984 PA 427, and others)
- MERS Board as Plan Trustee and Investment Fiduciary: bargaining issues and 'fiduciary fences'
- Nature of funding obligation under MI law for pension and health benefits, Court cases/OPEB implications commencing in 2006
- Led to 2004 PA 490:
 - Expanded definition of MERS-eligible 'municipality'
 - Confirmed Board powers to establish "health and welfare benefits, and other post employment benefit programs"



Collective Bargaining and Employee Benefits

- PERA and Act 312 (implements MI Const art 4 sec 48) 'dominant' in public employment
(OAG #6244, 8/31/1984)
- Contract may 'negotiate' statute 'out of existence'
- Negotiations subject to MI Const art 9 sec 24
(Public pension accrued benefit protection/funding obligations)
- State Investment Act (PERSIA) implements MI Const art 9 sec 18 & 19



What are “Fiduciary Fences”?

Action of Retirement Board (in exclusive capacity of Trustee and Fiduciary of Plan) with uniform MERS-wide application to harmonize Plan and bargaining on benefits:

- Foster plan integrity (short/long term fiscal impact, actuarial, and technological capability).
- Goal: to deliver the MERS benefits the municipality has promised when due (consistent with state and federal law).
- 1997: requirement for “current” actuarial valuation as precondition for approving benefit change.
(Amendment to Investment Act by 2002 PA 728, sec 20h(3)).



The Role of Trusts

- GASB OPEB Standards 43 and 45 do not require benefits to be funded or assets be held in trust; but there are substantial incentives to do so.
- If assets are NOT held in trust:
 - Employer contributions to prefund OPEB benefits will not be counted against the OPEB cost in an employer’s annual financial report.
 - Plan assets will not be counted against accrued liabilities in OPEB plan’s financial report.
 - Investment return assumptions must reflect earnings on non-trust employer assets (e.g., short-term, fixed-income securities, usually between 2 - 4%), rather than pension fund investment return assumption (8%).



Municipality Example

Assets	Retiree Health Funding Vehicle	Not in Trust	Difference
Investment Return Assumption	8%	4%	-4%
ARC as a Percentage of Payroll			
General	19%	38%	19%
Police	27%	47%	20%
Average Liability			
Present Retirees			
General	60,000	100,000	40,000
Police	100,000	150,000	50,000
Future Retirees			
General	30,000	55,000	25,000
Police	35,000	75,000	40,000



OPEB Definition of Trust

- To count as a trust under OPEB standards:
 - Employer contributions to the plan must be irrevocable; and
 - Plan assets must be dedicated to providing benefits in accordance with the terms of the plan; and
 - Plan assets must be legally protected from creditors of the employer ('exclusive benefit' rule)



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RHFV: Addresses Existing Liability

MERS Retiree Health Funding Vehicle (RHFV) trust began operating September 2004 for adoption by any municipality as OPEB-compliant trust

- IRS Private Letter Ruling # 200418044
- Section 115 Governmental Integral Trust (Participating employers are political subdivisions of the state or other entities whose income is excluded from tax)
- Employer solely determines contribution structure and funding
- Provides economies of scale by investing assets in the MERS Total Market Fund (pension pool) Trust governed by MERS Board
- RHFV offers education and reduced fees on Actuarial Health Valuations to members
- About 60 municipalities have adopted (Q2/2007)



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HCSP: Individual Future Medical Expense Reimbursement Accounts

Health Care Savings Program trust started in June 2004

- IRS Private Letter Ruling # 200418044
- Employer-sponsored, tax-favored medical saving account for individual employees to cover their costs of post employment health care
- Employer and employees determine contributions structure
- Individual employee accounts invested in MERS portfolio/grow tax-free
- Account available for tax-free reimbursement of medical expenses upon leaving employment
- Over 70 municipalities have adopted (Q2/2007)



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Legal Structure for Employee and Retiree Health Insurance

- Public Non-Profit Health Plan Trust with 5 Member Board
- Municipal Risk Pool for Employee Health Benefits:
 - Public Employer Pooling Arrangement
(First authorized in 1999 by inter-governmental contracting law, MCL 124.5(2))
 - Licensed under State Insurance Code as a Health entity in Dec. 2004 (MEWA, "Multiple Employer Welfare Arrangement")
 - MERS Premier Health is first licensed municipal health pool under 1999 law (began enrollment May 2005)
- Over 50 municipalities have adopted (Q2/2007)



Drafting Lessons in MERS Health Care Programs

- MERS Board immunized these pool programs from bargained modification by "blow up" clause
- Health program language: Participation/coverage choices contractually not an "accrued financial benefit" under MI Const; nor shall any funding method other than "pay as you go" be required
- Health trust funds subject to same investment standards as public pension funds
- Trust funds dedicated exclusively for benefit of participants



Conditions for Pooled Success

- A comprehensive view of retirement – coordinating pension and health care benefits.
- Affordable and sustainable benefit designs – so retirees have lifetime access to income and health care.
- Equitable cost-sharing – spreading costs fairly without jeopardizing access to care.
- Encourage increased employee retirement savings – through tax-deferred contributions and other incentives.
- Stabilize growth in health care costs while ensuring quality of care.
- Maximize growth in professionally invested trust assets by federal and state tax exemption on all investment earnings



Concluding Observations

1. Numbers DO matter-greater pool size, greater economies of scale, where there are sound public policy limits on bargaining.
2. Pooling and fiscal responsibility plan provisions/legislation vital in the public pension and health arena: to proactively constrain long-term unaffordable benefit obligations. *Focus on the goose, not just the golden eggs.*
3. Judicial construction is critical:
 - Evolving nature of pension and health benefit and funding obligations under Mich Const art 9 section 24
 - Re-examine PERA and Act 312 "override" in pension/health arena of contrary State law/local charter provisions. *See: The Public Employment Relations Act, Conflicts and Possible Alternatives, CRC Report No. 285, January, 1997.*
 - Public policy (explicit legislation) exception to general rule of judicial deference to Arbitration awards



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Concluding Observations

4. Amend PERSIA (Public Employee Retirement System Investment Act), to statutorily impose "Fiduciary Fences" statewide on pension and health fund trustees, notwithstanding any other provision of law
 - Explicit limitations on public pension fund benefit increases
 - Requirement for health plan valuation on cost impact of benefit changes.OAG #6244 Epilogue



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The Challenge ...

"To preserve its ability to address [current] and emerging trends, America needs to return to fiscal discipline and focus on the future. At both ends of Pennsylvania Avenue and on both sides of the political aisle, we need leaders who will face the facts, speak the truth, partner for progress, and make tough choices. We also need leadership from our state capitols and city halls and from businesses, colleges and universities, charities, think tanks, the military and the media. So far, there have been too few calls for fundamental change and shared sacrifice."

Transforming Government to Meet the Demands of the 21st Century - Comptroller General of the United States David Walker (August 7, 2007 presentation to The Federal Midwest Human Resources Council and the Chicago Federal Executive Board, at p.4).



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